DEVELOPMENT BANK OF
FEDERATION OF BOSNIA AND HERZEGOVINA

Financial statements for the year
ended 31 December 2017 and
Independent auditor's report

This version of the report is a translation from the original, which was prepared in Bosnian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our financial reports and the accompanying audit report takes precedence over this translation.

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Responsibilities of the Management and Supervisory Board for the preparation and approval of the annual financial statements

The Management Board of the Bank is required to prepare financial statements of the Bank for each financial year which give a true and fair view of the financial position of the Bank and of the results of its operations and cash flows, in accordance with applicable accounting standards and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; making judgements and estimates that are reasonable and prudent; and preparing the financial statements on a going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements, following which the Supervisory Board is required to approve the annual financial statements for submission to the General Assembly for adoption.

The financial statements set out on pages 7 to 51 were authorised by the Management Board on 6 April 2018 for issuing to the Supervisory Board and are signed below to signify this:

On behalf of the Management Board

Salko Selman
President of the Management Board

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RB FBiH
Sarajevo

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6 April 2018

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INDEPENDENT AUDITOR'S REPORT

To the owners of Development Bank of Federation of Bosnia and Herzegovina

Opinion

We have audited the financial statements of the Development Bank of Federation of Bosnia and Herzegovina (the "Bank"), which comprise the statement of financial position as at 31 December 2017, the statement of profit or loss, statement of comprehensive income, statement of changes in equity, and the statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2017, and its financial performance and cash flows for the year then ended in accordance with the International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

As described in Note 20 to the financial statements, the total court proceedings against the Bank amount to KM 2,635 thousand as at 31 December 2017. Of the total amount, KM 2,233 thousand is related to labour dispute proceedings of employees against the Bank, and KM 402 thousand is related to other proceedings. The Management of the Bank believes that it is not possible to estimate the outcome of the outstanding proceedings, hence provisions on this basis have not been created as at 31 December 2017.

Our opinion is not qualified in respect of these matters.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the unconsolidated and consolidated financial statements of the current period. These matters were addressed in the context of our audit of the unconsolidated and consolidated financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters (continued)

Impairment losses on loans and receivables from clients

Given loans and receivables from clients comprise 64% of Bank's total assets, and they are subject to significant applied estimates of the Management of the Bank. Refer to Note 2 on page 17 of the financial statements for the accounting policies, and Note 14 on page 30 for additional information respectively.

When there is objective evidence of impairment of loans to and receivables from customers, such as significant difficulties of the debtor, breach of the contractual terms, approving the credit relief to a debtor due to financial difficulties, certain initiation of a bankruptcy proceeding or financial reorganization of a debtor, disappearance of an active market or data that indicates measurable decrease of estimated future cash flows, the Bank assesses certain financial assets for impairment on an individual basis, and the remaining financial assets on a group basis.

Management applies judgment to assess the inputs they find relevant for the calculation of impairment losses on loans and receivables from client on individual basis including, but not limited to, financial position of the client, realization period and value of the collateral at the projected realization date, the expected cash flows and the current local and global economic conditions.

For the group assessment of an impairment for incurred but not reported losses (IBNR), and specific provisions calculated on group basis, the Group and the Bank use statistical models and historical data on the probability of events causing impairment, time required for recovery, and the total amount of incurred loss, adjusted for the Management's judgement on whether the current economic and credit conditions are such that it is probable that the actual losses will be higher or lower than those calculated based on historical data.

How our audit addressed the key audit matter

During the audit we gained an understanding of the Bank's provisioning process through the interviews with responsible personnel, and review of the policies and procedures to consider their adequacy, consistency of controls and employees' responsibilities. The aforementioned resulted in defining the adequate audit procedures to be able to address the risks associated with the impairment losses on loans and receivables from clients.

Our audit procedures were focused on and included the following:

Operating effectiveness of controls

We tested the design and implementation of key controls and tested their operating effectiveness, which are related to testing of impairment losses, with the special focus on:

- control of the counter of days to maturity and probability of default;
- control of input of data in the system on approved loans and receivables from clients, and value of collateral;
- control of the parameters used for calculation of impairment losses on a group basis.

Automatic controls

We tested the design and implementation and tested operating effectiveness of automatic controls identified as significant for our evidence procedures and testing impairment losses. Testing of these controls created a basis for selecting a sample and further testing of impairment of individual loans and receivables from clients.

Key Audit Matters (continued)

How our audit addressed the key audit matter (continued)

Individual assessment of impairment losses

Based on the reconciled population of given loans classified as *"individually impaired"* with synthetic records, we determined the sample for our evidence procedures using statistical solutions provided by audit methodology and our own judgement based on previous knowledge of the client's portfolio and monitoring the most significant movements from the status of performing to non-performing clients.

We performed our testing on the selected sample to assess and determine the existence of potential indicators of the fact that certain loans and receivables and finance lease are inadequately or redundantly provisioned. In this process, we used on judgement to determine parameters for calculation of impairment losses on loans and compared our own calculation with the impairment losses on loans calculated by the Bank. We have analysed the financial positions of the clients, adequacy of the forecasted cash flows compared to actual ones and historical data, the quality of collateral and the adequacy of its assessment, all in accordance with stipulated internal procedures and Bank's methodology. We enquired any breaches of contracts and/or changes from the original terms and conditions of the contract. We additionally considered the impact of the current local and global economic conditions, as well as the group of related parties, and other factors that may affect the recoverability of the loans in the sample. For the same sample of loans, we assessed loan loss provisions that the Bank calculates in accordance with regulations of the Banking Agency of Federation of BiH ("FBA") depending on days overdue, financial position of a debtor and collateral, following the percentages of provisions for the purpose of their adequacy assessment.

Collective assessment of impairment losses

During our audit, we have gained an understanding of the Bank's provisioning process, methodology and parameters used in the calculation of collective impairment losses on loans in order to evaluate the overall adequacy of the collective impairment level. In accordance with internal methodology, we selected a sample of clients, for which we tested the adequacy of recognized impairment losses on a group basis following the requirements of the Bank's methodological framework and testing the Bank's internal model in assessing the parameters for Incurred But Not Reported (IBNR) provisioning. The model was tested by a retrospective review.

We recalculated provisions for the same sample that the Bank calculates in accordance with regulations of the Banking Agency of Federation of BiH depending on days overdue, financial position of a debtor and collateral, as well as stipulated percentages of provisions for the purpose of their adequacy assessment.

Other Matters

Bank's financial statements for the year ended 31 December 2016 were audited by another auditor, who expressed an unmodified opinion on 10 March 2017.

Responsibilities of the Management and Supervisory Boards for the Financial Statements

The Management Board is responsible for the preparation and fair presentation of the accompanying financial statements in accordance with the International Financial Reporting Standards, and for such internal control as the Management Board determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Responsibilities of the Management and Supervisory Boards for the Financial Statements (continued)

In preparing the financial statements, the Management Board is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Supervisory Board is responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's and the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the unconsolidated and consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank and the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the unconsolidated and consolidated financial statements, including the disclosures, and whether the unconsolidated and consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Auditor's Responsibilities for the Audit of the Financial Statements (continued)

During the audit, we communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Deloitte d.o.o.

Sead Bahtanović, director and licensed auditor

Sabina Softić, partner and licensed auditor

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Zmaja od Bosne 12c
Sarajevo, Bosnia and Herzegovina
6 April 2018

(All amounts are expressed in thousand KM, unless otherwise stated)

	Notes	2017	2016
Interest income	4	8,528	9,771
Interest expense	5	(91)	(100)
Net interest income		**8,437**	**9,671**
Fee and commission income	6	1,665	1,917
Net fee and commission income		**1,665**	**1,917**
Other operating income	7	231	364
Operating income		**10,333**	**11,952**
Personnel expenses	8	(5,719)	(4,964)
Depreciation and amortisation		(467)	(433)
Administrative and other expenses	9	(1,556)	(1,824)
Operating expenses		**(7,742)**	**(7,221)**
Profit before impairment losses and provisions		**2,591**	**4,731**
Impairment losses and provisions	10	(2,463)	(2,987)
Profit before tax		**128**	**1,744**
Income tax	2(e)	-	-
Net profit for the year		**128**	**1,744**

The accompanying notes form an integral part of these financial statements.

	Notes	2017	2016
Net profit for the year		**128**	**1,744**
Other comprehensive income for the year		-	-
Total comprehensive income for the year		**128**	**1,744**

The accompanying notes form an integral part of these financial statements.

(All amounts are expressed in thousand KM, unless otherwise stated)

	Notes	31 December 2017	31 December 2016
Assets			
Cash and cash equivalents	11	89,797	89,838
Obligatory reserve with the Central Bank	12	13,619	9,043
Loans to and receivables from banks	13	-	-
Loans to and receivables from customers	14	194,889	182,256
Other assets	15	528	944
Property and equipment	16	4,619	4,811
Intangible assets	17	145	209
Total assets		**303,597**	**287,101**
Liabilities			
Current accounts and deposits from customers	18	116,783	90,437
Borrowings	19	2,282	3,035
Provisions	20	1,070	910
Other liabilities	21	7,418	16,803
Total liabilities		**127,553**	**111,185**
Equity			
Registered capital	22	163,615	163,615
Retained earnings		4,372	4,244
Regulatory reserves for credit losses		8,057	8,057
Total equity		**176,044**	**175,916**
Total liabilities and equity		**303,597**	**287,101**

The accompanying notes form an integral part of these financial statements.

(All amounts are expressed in thousand KM, unless otherwise stated)

	2017	2016
Operating activities		
Profit for the year	128	1,744
Adjustments for:		
Depreciation and amortisation	467	433
Impairment losses and provisions, net	2,463	2,987
Net interest income	(8,437)	(9,671)
	(5,379)	(4,507)
Changes in:		
Net increase in obligatory reserve with the Central Bank	(4,576)	(4,415)
Net (increase) / decrease in given loans and receivables	(14,638)	27,712
Net decrease / (increase) in other assets	227	(316)
Net increase / (decrease) in current accounts and deposits from customers	26,346	(13,396)
Net (decrease) / increase in other liabilities	(9,833)	10,175
	(7,853)	15,253
Interest received	8,867	9,062
Interest paid	(91)	(100)
Net cash from operating activities	**923**	**24,215**
Investing activities		
Purchase of property and equipment	(205)	(143)
Purchase of intangible assets	(6)	-
Net cash used in investing activities	**(211)**	**(143)**
Financial activities		
Repayment of borrowings	(753)	(431)
Net cash used in financial activities	**(753)**	**(431)**
Net (decrease) / increase in cash and cash equivalents	**(41)**	**23,641**
Cash and cash equivalents at the beginning of the year	**89,838**	**66,197**
Cash and cash equivalents at the end of the year	**89,797**	**89,838**

The accompanying notes form an integral part of these financial statements.

(All amounts are expressed in thousand KM, unless otherwise stated)

	Registered capital	**Regulatory reserves for credit losses**	**Retained earnings**	**Total**
As at 1 January 2016	**163,615**	**8,057**	**2,500**	**174,172**
Net profit for the year	-	-	1,744	1,744
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	*1,744*	*1,744*
As at 31 December 2016	**163,615**	**8,057**	**4,244**	**175,916**
Net profit for the year	-	-	128	128
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	*128*	*128*
As at 31 December 2017	**163,615**	**8,057**	**4,372**	**176,044**

The accompanying notes form an integral part of these financial statements.

1. GENERAL

History and incorporation

The Development Bank of Federation of Bosnia and Herzegovina (the "Bank") was established by the Law on the Development Bank of Federation of Bosnia and Herzegovina ("Official Gazette of Federation of Bosnia and Herzegovina", no. 37/08). The Bank is headquartered in Igmanska 1, Sarajevo. The Bank is in 100% ownership of Federation of Bosnia and Herzegovina.

In compliance with the Law on the Development Bank and the Statute of the Bank, bodies of the Bank are: the Assembly (consisting of the Government of FBiH), the Supervisory Board, the Management Board and the Audit Board.

As of 31 December 2017, the Bank had branch offices in Mostar, Bihać, Zenica, Orašje, Tuzla and Livno.

Principal activities of the Bank

The goals of the Bank are encouragement of economic development and overall social development and the encouragement of sustainable growth on the territory of Federation of Bosnia and Herzegovina, relating to the financial and general social goals defined by the Law on the Development Bank.

Corporate loan and guarantee approvals are the key activities of the Bank either directly or through other banks, in order to support the local economy, regional development and employment. The Bank performs credit operations in the name and on behalf of the Bank (from capital, collected deposits and borrowings), as well as in the name and on behalf of the Federation of BiH, on which behalf it manages its domestic and foreign funds aimed for development projects, as well as receives cash deposits and takes loans, as a function of financing development projects.

Management Bodies of the Bank

Supervisory Board:

Igor Živko	Chairman
Božo Vukoja	Member
Zvonko Landeka	Member
Asim Omanić	Member
Amir Avdić	Member
Semir Fejzić	Member

Management Board:

Salko Selman	President of the Management Board
Marijan Oršolić	Vice President of the Management Board

Audit Board:

Drago Novaković	Chairman
Fatima Obhodžaš	Vice-Chairwoman
Haladin Salihović	Member
Dželmina Huremović	Member
Suada Isaković	Member

1. GENERAL (CONTINUED)

The Supervisory Board, as a control body, has a significant role in overseeing the Bank's operations and representing the owner's interests; together with the members of the Management Board of the Bank, the Supervisory Board is responsible for the preparation of financial statements in accordance with statutory provisions.

Assembly of the Bank

During 2017, the Assembly of the Bank held no meetings, and has not discussed the report on operations of the Bank for 2016, inter alia.

Supervisory Board

According to the Law on the Development Bank of FBiH, the Supervisory Board of the Bank consists of the Chairman and six members, which are appointed and dismissed by the Assembly. In addition, the aforementioned is defined by the Statute of the Development Bank of FBiH as well and by the adopted Rulebook on Functioning of the Supervisory Board of the Development Bank of FBiH (February 2010).

The Supervisory Board of the Bank has not been functional during 2017 and at the beginning of 2018, and the seventh member of the Supervisory Board has not been appointed due to absence of meetings of the Assembly of the Bank. As at the date of this report, the Supervisory Board comprised total of six members (including the Chairman), which is not in accordance with the stated Law, the Statute and the adopted Rulebook.

The Supervisory Board has approved the Business plan and financial plan of the Bank for 2017 as late as March 2018. As at the date of this report, the Supervisory Board of the Bank has not adopted the latest proposition of the Workplace Systematization and Organization of the Bank. The Supervisory Board has not discussed the proposition of the new Workplace Systematization and Organization of the Bank, which was adopted by the Management Board during 2017.

Management Board of the Bank

Pursuant to the Law on the Development Bank of FBiH and the Statute of the Bank, the Management Board comprises the President of the Management Board and executive directors, appointed and dismissed by the Supervisory Board.

According to the organizational scheme adopted in 2009, the Management Board of the Bank comprises: President, Vice President and functions of two executive directors – Executive Director for Research, Development and Crediting, and Executive Director for Support to Operations and Assets Management. On the other hand, in February 2017, the Supervisory Board adopted the "Scheme of Internal Organization and Systematization of Workplaces and Work Tasks", according to which functions of three executive directors are defined in addition to the president and vice president – Executive Director for Projects and Development, Executive Director for Risk Management, and Executive Director for Support to Operations.

Since 7 September 2017, the Management Board has operated with incomplete structure, i.e. the positions of executive directors of the Bank have been vacated, thus the Management Board comprises only the President and Vice President of the Management Board as at the date of this report. Accordingly, the composition of the Management Board is not in compliance with the Law on the Development Bank of FBiH.

Secretary of the Bank

The Bank has no Secretary of the Bank since 23 September 2017.

1. GENERAL (CONTINUED)

a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board.

The Bank's financial statements were authorized for issue by the Management Board on 6 April 2018 for submission to the Supervisory Board.

b) Going concern

The financial statements have been prepared on a going concern basis, which means that the Bank will be able to realize its receivables and settle its liabilities in the ordinary course of business.

c) Basis of measurement

These financial statements have been prepared on the historical or amortised cost basis.

d) Functional and presentation currency

The financial statements are presented in Convertible Marks ("KM"), which is the functional currency of the Bank.

The Central Bank of Bosnia and Herzegovina ("CBBiH" or "Central Bank") implemented a currency board arrangement aligning BAM to EURO at an exchange rate of EUR 1: BAM 1.95583 throughout 2017 and 2017. This is expected to continue in the foreseeable future.

e) Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which they are revised and potentially in future periods if they affect them.

Information on areas with significant uncertainty in the estimates and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in these financial statements are disclosed in Note 3.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been consistently applied for all periods presented in these financial statements.

a) Foreign currency transactions

Transactions in foreign currencies are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange profits and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

b) Interest income and expense

Interest income and expense are recognised in the income statement as they accrue using the effective interest rate method. Effective interest rate is the rate that discounts estimated future cash flows of financial assets or liabilities over the life of financial instrument (or, if appropriate, a shorter period) to its net carrying value. In the calculation of effective interest rates the Bank estimates future cash flows considering all contractual terms, but not future credit losses.

Calculation of the effective interest rate includes all paid or received transaction costs, fees and points, which are an integral part of the effective interest rate. Transaction costs include all incremental costs incurred directly in connection with the issuance or acquisition of financial assets or financial liabilities.

Interest income and expense recognised in the income statement include interest on financial assets and financial liabilities that are measured at amortised cost calculated using the effective interest rate method.

c) Fee and commission income and expenses

Fee and commission income and expenses that are integral part of the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Fee and commission income and expenses, reported as such, mainly comprise of fees related to agency activities, the issuance of guarantees and letters of credit and other services and are recognised in the income statement upon performance of the relevant service.

d) Operating lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

e) Income tax

According to Article 32 of the Law on Development Bank of the Federation of Bosnia and Herzegovina (Official Gazette of Federation of Bosnia and Herzegovina, No. 37/08), the Bank is not subject to corporate income tax.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f) Financial instruments

Recognition

Loans and receivables, and other financial liabilities are recognised when advanced to borrowers or received from lenders (settlement date).

Classification

The Bank classifies its financial instruments in the following categories: loans and receivables and other financial liabilities. The classification depends on the purpose for which the financial assets and liabilities were acquired. The Management determines the classification of financial assets and liabilities upon initial recognition and re-evaluates this classification at each reporting date.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables arise when the Bank provides money to a debtor with no intention of trading with the receivable and include placements with and loans to other banks, loans to customers and balances with the Central Bank.

Other financial liabilities

Other financial liabilities comprise of all other financial liabilities, including current and deposit accounts and borrowings.

Initial and subsequent measurement

Loans and receivables and other financial liabilities are initially recognized at fair value. Loans and receivables and other financial liabilities are subsequently measured at amortized cost, using the effective interest rate method, less any impairment.

Derecognition

The Bank derecognizes financial assets (in full or in part) when the contractual rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights on those financial assets. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realized, surrendered or have expired.

The Bank derecognizes financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognizing that liability and will instantaneously recognize a new financial liability, with new terms and conditions.

Identification and measurement of impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has (or have) an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f) Financial instruments (continued)

Identification and measurement of impairment of financial assets (continued)

Objective evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the group.

For financial assets carried at amortised cost, the Bank first assesses whether objective evidence of impairment exists individually or collectively. Those individual assets which are not identified as impaired are subsequently included in the basis for collective impairment assessment. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred) discounted at the original effective interest rate of financial assets valid at the time the asset become impaired. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

For individually significant loans, the need for, and amount of impairment allowance is determined based on an assessment which includes the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of working capital and other financial support, the realisable value of collateral, and the timing of the expected cash flows.

Allowances are assessed collectively for losses on loans to customers where there is no objective evidence of individual impairment. For the purpose of collective evaluation of impairment the Bank uses statistical models and historical data on the probability of occurrences that cause impairment, the time required to recover and the total loss incurred, adjusted for management's judgement as to whether the current economic and credit conditions are such that it is likely that the actual losses will be higher or lower of those calculated by historical modelling. The Bank regularly reviews the loss rates and the expected rates of recovery at each reporting date, to ensure accurate reporting.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognised in the income statement.

When a loan is uncollectible, it is written off against the related impairment allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised as a reversal of impairment losses in the income statement.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f) Financial instruments (continued)

Identification and measurement of impairment of financial assets (continued)

The Bank also calculates provisions in accordance with the relevant regulations of the Banking Agency of the Federation of Bosnia and Herzegovina ("the Agency" or "FBA"). In accordance with these regulations, the relevant placements are classified into appropriate risk groups, depending on the past due days, the financial position of the borrower and collateral; and are provided for at prescribed rates. A general provision is also calculated in accordance with these regulations at a rate of 2% on exposure not specifically impaired.

Provisions calculated in the manner described in the previous paragraph ("FBA reserves") are not recognized in these financial statements of the Bank. If the impairment for potential losses calculated in accordance with the regulations of the Agency is greater the impairment calculated in accordance with the requirements of IFRS, this difference is presented as adjustments in the calculation of capital adequacy.

Fair values of financial assets and liabilities

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access. The fair value of a liability expresses its risk of non-performance.

Where available, fair value is measured using the quoted price in an active market. The market is considered active if the transaction for asset or liability occur with sufficient frequency and to the extent sufficient to provide information about prices on a regular basis (Level 1 fair value hierarchy).

In circumstances where the quoted market prices are not readily available, the Bank then uses valuation techniques that maximize the use of observable inputs (Level 2 and Level 3 fair value hierarchy) and minimize the use of unavailable input data. Selected valuation techniques include all factors that market participants would take into account when determining the price of the transaction.

Analysis of financial instruments that are measured subsequent to initial recognition at fair value are grouped into Levels 1 to 3 as follows:

- Level 1 - fair value derived from quoted prices in active markets
- Level 2 - fair value measurements derived from inputs other than quoted prices included in level 1;
- Level 3 - fair value derived from valuation techniques that are not based on observable market data.

Specific financial instruments

Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents comprise of cash, balances with the Central Bank and current accounts with other banks.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f) Financial instruments (continued)

Specific financial instruments (continued)

Cash and cash equivalents (continued)

Cash and cash equivalents exclude the compulsory minimum reserve with the Central Bank as these funds are not available for the Bank's day-to-day operations. The compulsory minimum reserve with the Central Bank is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

Obligatory reserve with the Central Bank

Obligatory reserve with the Central Bank is classified as loans and receivables and measured at amortized cost less impairment losses.

Loans and advances

Loans and advances to banks and customers are presented at amortised cost net of impairment allowances to reflect the estimated recoverable amounts.

Borrowings

Interest-bearing borrowings are classified as other financial liabilities and are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, these are stated at amortised cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the income statement over the period of the borrowings using the effective interest rate method.

Current accounts and deposits from customers

Current accounts and deposits are classified as other liabilities and are initially measured at fair value plus transaction costs and subsequently stated at their amortised cost using the effective interest method.

g) Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and impairment losses. The cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent cost is included in net book value or is accounted for as separate assets only if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of day-to-day repairs and maintenance are recognised in the income statement as incurred.

Depreciation is provided on all property and equipment except for land and assets in the course of construction on a straight-line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The depreciation rates used by the Bank are as follows:

Buildings	3%
Furniture and equipment:	
- Furniture and other office equipment	20%-33,33%
- Mobile phones	50%
Vehicles	20%
Leasehold improvements	20%

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

g) Property and equipment (continued)

Depreciation method and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains and losses on disposal are determined by comparing proceeds with the carrying amount, and are included in the income statement as other income or operating expense.

h) Intangible assets

Intangible assets are stated at historical cost less accumulated amortisation and impairment losses. The cost includes all expenditure that is directly attributable to the acquisition of the items.

Amortization is provided on all intangible assets except assets in the course of construction on a straight line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The following estimated useful lives are used:

Software	20%

Amortization method, useful lives and net values are reassessed, and adjusted if appropriate, at each reporting date.

i) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount, impairment losses are recognised in the income statement.

The recoverable amount of other assets is the greater of their value in use and fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

j) Employee benefits

Short-term benefits

On behalf of its employees, the Bank pays pension and health insurance which is calculated on the gross salary paid, as well as tax on salaries which are calculated on the net salary paid. The Bank pays the above contributions into the state pension and health funds according to statutory rates during the course of the year. In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with local legislation. These expenses are recorded in the income statement in the period in which the salary expense is incurred.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

j) Employee benefits

Short-term benefits (continued)

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Long-term benefits: retirement severance payments

According to the local legislation the Bank pays to its employees retirement severance benefits upon retirement in an amount of six employee's salaries received in the last six months or six average salaries at the Federation of BiH level in the last six months, depending on what is more favourable for the employee.

The obligation and costs of these benefits are determined by using a projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the estimated interest rate on government bonds.

k) Provisions for liabilities and expenses

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made, or as required by law in the case of provisions for unidentified impairment of off-balance-sheet credit risk exposures.

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of incurred losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.

Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

l) Registered capital

Registered capital consists of 100% share of the Federation of BiH.

Regulatory reserve for credit losses

The regulatory reserve for credit losses represents the surplus of impairment allowances calculated in accordance with regulations as prescribed by the Agency over impairment allowances recognised in accordance with IFRS. The reserve is presented directly within equity (as a non-distributable reserve) and until 2012 any increase of the surplus was covered by transfers from retained earnings, after approval by shareholders.

Prior to 2012, the need for transfers from retained earnings to an earmarked reserve within equity (regulatory reserve for credit losses) was calculated for the whole credit-risk portfolio on a net basis, thereby taking into account both instances where application of Agency regulations would have resulted in a higher provision and instances where the application of Agency regulations would have resulted in a lower provision.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

l) Registered capital

Regulatory reserve for credit losses (continued)

However, from 2012, banks are required to calculate the requirement for regulatory reserves for credit losses taking into account only instances where higher provisions would have resulted from the application of the Agency rules. Retroactive application of this change in Agency rules is not required.

Based on the Decision issued by the Agency in February 2013 any increase of the surplus of regulatory provisions no longer needs to be presented as a reserve movement within equity but will be exclusively computed as a deduction of regulatory capital for the purpose of capital adequacy calculations. Therefore, the reserve shown in the financial statements as at and for the year ended 31 December 2012 remained unchanged until 31 December 2017.

m) Off-balance sheet commitments and contingent liabilities

In the ordinary course of business, the Bank enters into credit-related commitments which are recorded in off-balance-sheet accounts and primarily comprise of guarantees, letters of credit and undrawn loan commitments. Such financial commitments are recorded in the Bank's statement of financial position if and when they become payable.

n) Funds managed for and on behalf of third parties

The Bank manages significant funds for and on behalf of the Government of the FBiH (Ministry of Finance, Ministry of Development, Entrepreneurship and Craft, Ministry of Agriculture, Water Management and Forestry, Ministry of Displaced Persons and Refugees, Ministry of Environment and Tourism and Ministry of Energy, Mining and Industry) and the Federal Employment Agency. Income and expenses from such operations are charged to the principal and the Bank does not bear any liabilities and risks. For these services, the Bank charges fees. For details refer to Note 24.

o) Standards and interpretations effective in the current period

The following new amendments to the existing standards issued by the International Accounting Standards Board (IASB) are effective for the current reporting period:

- Amendments to IAS 7 "Statement of Cash Flows" – Disclosure Initiative (effective for annual periods beginning on or after 1 January 2017);
- Amendments to IAS 12 "Income Taxes" – Recognition of Deferred Tax Assets for Unrealised Losses (effective for annual periods beginning on or after 1 January 2017);
- Amendments to IFRS 12 due to "Improvements to IFRSs (cycle 2014-2016)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017).

The adoption of these standards, amendments and interpretations has not led to any material changes in the Bank's accounting policies.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

p) Standards and interpretation in issue not yet adopted

At the date of authorisation of these financial statements, the following new standards, amendments to existing standards and new interpretation were in issue, but not yet effective:

- IFRS 9 "Financial Instruments" (effective for annual periods beginning on or after 1 January 2018);
- IFRS 15 "Revenue from Contracts with Customers" and further amendments (effective for annual periods beginning on or after 1 January 2018);
- IFRS 16 "Leases" (effective for annual periods beginning on or after 1 January 2019);
- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2021);
- Amendments to IFRS 2 "Share-based Payment" - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018);
- Amendments to IFRS 4 "Insurance Contracts" - Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 "Financial Instruments" is applied first time);
- Amendments to IFRS 9 "Financial Instruments" - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019);
- Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures" - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded);
- Amendments to IAS 28 "Investments in Associates and Joint Ventures" - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019);
- Amendments to IAS 40 "Investment Property" - Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018);
- Amendments to IFRS 1 and IAS 28 due to "Improvements to IFRSs (cycle 2014-2016)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018);
- Amendments to various standards due to "Improvements to IFRSs (cycle 2015-2017)" resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after 1 January 2019);
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after 1 January 2018);
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after 1 January 2019);

The Bank has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Bank anticipates that the adoption of these standards, revisions and interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

q) IFRS 9: "Financial Instruments"

Entity's business model for financial assets management and contractual characteristics of cash flow from financial assets are used basis for classification of debt assets. Accordingly, debt instruments should be measured at amortized cost if:

a) business model is holding financial assets exclusively for obtaining contractual cash flows,

b) contractual cash flows exclusively maintain payments of principal and interest.

All other debt instruments and equity instruments, including investments in complex loan instruments and capital investments, must be recognized at fair value and are presented in the statement of profit or loss, except for capital investments not held for trading, which can be recorded in profit or loss or in the reserve.

Requirements of the new standard in the area of impairment are based on the expected credit losses model, and it substitutes the current IAS 39 incurred losses model. The new expected credit loss model includes three phases of access, whereby financial assets are moved through phases as their credit quality changes. In the first phase, the expected credit loss is calculated for the period of 12 months, and for the following two phases, the expected losses are calculated for the entire life of an instrument.

The Bank has already performed a review of the contractual characteristics of the portfolio, and determined that the entire portfolio of loans and receivables is measured at amortized cost. Calculations demonstrate that the transition to the new standard has an effect of decrease in financial assets due to increase in the impairment losses in the Bank's statement of financial position in the amount of KM 5,257 thousand. The same amount will represent a decrease of the Regulatory reserve for credit losses and retained earnings

It is planned that the Standard will be effective from 1 January 2018 and the first application effects will be presented through the correction of opening balances in the Bank's statement of financial position.

3. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated and are based on historical experience and other factors such as the expected flow of future events that can be reasonably assumed in existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty. The estimation of impairment losses in the Bank's credit risk portfolio represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty, that have a significant risk of causing a possible material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

Impairment losses on loans and receivables and provisions for off-balance-sheet exposure

The Bank monitors the creditworthiness of its customers on an ongoing basis. The need for impairment of the Bank's on and off-balance sheet exposure to credit risk is assessed on a monthly basis.

Impairment losses are made mainly against the carrying value of loans to banks and customers (as disclosed in Notes 13 and 14) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 20).

The Bank estimates impairment losses in cases where it judges that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets. Such evidence includes delinquency in payments or other indications of financial difficulty of borrowers and adverse changes in the economic conditions in which borrowers operate or in the value or enforceability of security, where these changes can be correlated with defaults.

Summary of impairment allowances and provisions	**Note**	**31 December 2017 '000 KM**	**31 December 2016 '000 KM**
Impairment allowance for balance sheet exposures, including IBNR and other assets	13, 14, 15	33,665	31,537
Provisions for off-balance sheet exposures	20	339	380
		34,004	**31,917**

As at 31 December 2017 and 31 December 2016, the gross value of impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognized were as follows:

KM '000	**31 December 2017**			**31 December 2016**		
	Loans to banks	**Loans to clients**	**Total**	**Loans to banks**	**Loans to clients**	**Total**
Gross exposure	1,534	73,189	**74,723**	1,534	55,507	**57,041**
Impairment allowance	(1,534)	(26,535)	**(28,069)**	(1,534)	(23,302)	**(24,836)**
Impairment rate	100%	36%	**38%**	100%	42%	**44%**

In addition to identified losses on impaired loans, as described above, the Bank also recognizes impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified ("IBNR").

(All amounts are expressed in thousand KM, unless otherwise stated)

3. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (CONTINUED)

Impairment losses on loans and receivables and provisions for off-balance-sheet exposure (continued)

The amount of IBNR as at 31 December 2017 amounted to KM 5,261 thousand (2016: KM 5,427 thousand) or 2.66% (2016: 2.98%) of loans and receivables.

Regulatory requirements

The Agency is entitled to carry out regulatory inspections of the Bank's operations and to request changes to the carrying values of assets and liabilities, in accordance with the underlying regulations.

In addition to impairment allowances calculated and recognized in accordance with IFRS, the Bank also calculates impairment losses in accordance with Agency regulations for capital adequacy calculation purposes and regulatory reserves for credit losses.

The following table summarizes impairment allowances calculated in accordance with the Agency regulations. Regulatory provisions as of 31 December 2017 are calculated in accordance with the new methodology (as explained in Note 2 l).

Summary of impairment allowances	**31 December 2017**	**31 December 2016**
Provisions for balance-sheet exposure (Agency)	42,857	39,696
Provisions for off-balance–sheet exposure (Agency)	1,491	209
	44,348	39,905
Impairment allowances under IFRS	34,004	31,917
Negative difference between provisions for balance-sheet exposure (Agency) and impairment allowance in accordance with IFRS	1,638	2,728
Missing reserves	11,982	10,716

Prior to 2012, any increase in allowance in accordance with the Agency regulations over amounts recognized under IFRS were required to be transferred to regulatory reserves from profit or retained earnings, upon the decision of the General Assembly. However, as explained in Note 2 (f), based on the new Decision issued by the Agency in February 2013 any further shortfall in regulatory provisions will be adjusted as a deduction of regulatory capital in the capital adequacy calculation without any transfer of this shortfall from retained earnings to regulatory reserves for credit losses within equity.

As presented in the above table, total Agency provisions exceeded provisions recognized under IFRS by KM 11,982 thousand as at 31 December 2017 (31 December 2016: KM 10,716 thousand). Out of this amount, KM 8,057 thousand has been recognized as a regulatory reserve for credit losses within equity as at 31 December 2017 (31 December 2016: KM 8,057 thousand). The remaining amount of KM 3,925 thousand, which represents the current year shortfall, in line with the new Agency regulation, as explained above, will not be transferred to the regulatory reserves for credit losses, but will be recorded as a reduction of regulatory capital and is calculated only for regulatory reporting purposes.

Court proceedings

The Bank performs individual assessment of all court cases and on that basis determines the amount of provisions.

(All amounts are expressed in thousand KM, unless otherwise stated)

3. ZNAČAJNE RAČUNOVODSTVENE PROCJENE I KLJUČNI IZVORI PROCJENE NEIZVJESNOSTI (NASTAVAK)

As indicated in Note 20, the Bank provisioned KM 34 thousand, which is the amount that the Management considered sufficient. Since the assessment is made for each case separately, it is not practicable to estimate the financial impact of changes in the assumptions based on which the Management estimates the need for provisions at the reporting date.

4. INTEREST INCOME

	2017	2016
Interest on loans to customers	8,528	9,771
	8,528	**9,771**

5. INTEREST EXPENSE

	2017	2016
Interest on borrowings and deposits	91	100
	91	**100**

6. FEE AND COMMISSION INCOME

	2017	2016
Fee income from agency activities	1,335	1,503
Fee income from guarantees and letters of credit	39	62
Fees from other transactions	291	352
	1,665	**1,917**

7. OTHER OPERATING INCOME

	2017	2016
Income from sale of acquired real estate	119	106
Donations	46	104
FX gains	-	62
Other	66	92
	231	**364**

8. PERSONNEL EXPENSES

	2017	2016
Net salaries	2,385	2,197
Taxes and contributions	1,794	1,589
Other	1,540	1,178
	5,719	**4,964**

Personnel expenses include KM 994 thousand (2016: KM 910 thousand) of defined pension contributions paid into the State pension fund. Contributions are calculated as percentage of the gross salary paid. The average number of employees during the year ended 31 December 2017 was 121 (2016: 120).

(All amounts are expressed in thousand KM, unless otherwise stated)

9. ADMINISTRATIVE AND OTHER EXPENSES

	2017	2016
Bank fees	271	117
Memberships and charges	223	327
Supervisory Board and Audit Board remunerations	179	155
Maintenance	175	185
Energy	129	127
Telecommunications	126	138
Materials	93	89
Advertising, entertainment, sponsorship	79	163
Services	72	98
Rent	46	48
Insurance	17	14
Other expenses	146	363
	1,556	**1,824**

10. IMPAIRMENT LOSSES AND PROVISIONS, NET

	2017	2016
Loans to clients (Note 14)	2,005	2,753
Provisions for employee benefits (Note 20)	242	98
Impairment of acquired assets (Note 15)	149	107
Impairment of other assets (Note 15)	108	9
Income from release of / additional impairment allowance for contingent liabilities and court proceedings (Note 20)	(41)	20
	2,463	**2,987**

11. CASH AND CASH EQUIVALENTS

	31 December 2017	31 December 2016
Current accounts with the Central Bank of Bosnia and Herzegovina	76,309	72,182
Current accounts with other banks in foreign and domestic currency	13,472	17,636
Cash in hand	16	20
	89,797	**89,838**

Cash and current accounts with other banks include KM 6,469 thousand (2016: KM 15,731 thousand) of funds managed for and on behalf of third parties (Note 24).

(All amounts are expressed in thousand KM, unless otherwise stated)

12. OBLIGATORY RESERVE WITH THE CENTRAL BANK

	31 December 2017	31 December 2016
Obligatory reserve with the Central Bank of Bosnia and Herzegovina	13,619	9,043
	13,619	**9,043**

During the reporting period the Bank has maintained the prescribed mandatory reserves with the Central Bank (CBBiH), by applying a 10% rate on all deposits.

For the amount of obligatory reserve and liquidity funds held with the Central Bank of Bosnia and Herzegovina (CBBiH), no interest was accounted on above mentioned amounts by the CBBiH in 2017.

13. LOANS AND RECEIVABLES FROM BANKS

	31 December 2017	31 December 2016
Loans to banks	1,534	1,534
Less: impairment allowance	(1,534)	(1,534)
Total net loans to banks	**-**	**-**

Loans and advances to banks include interest receivable in the amount of KM 127 thousand (31 December 2016: KM 127 thousand).

14. LOANS AND RECEIVABLES FROM CLIENTS

	31 December 2017	31 December 2016
Corporate	1,161	1,239
Current portion of long-term loans	25,471	25,053
	26,632	**26,292**
Long-term loans (excluding current portion):		
Corporate	193,948	179,737
Retail	4,909	4,956
	198,857	**184,693**
	225,489	**210,985**
Less: impairment allowance	(30,600)	(28,729)
	194,889	**182,256**

Loans to customers include interest receivables, which comprise of unpaid due interest and fees, and accrued interest in the amount of KM 1,073 thousand (31 December 2016: KM 802 thousand) and are presented net of deferred fees in the amount of KM 1,072 thousand (31 December 2016: KM 969 thousand).

(All amounts are expressed in thousand KM, unless otherwise stated)

14. LOANS AND RECEIVABLES FROM CLIENTS (CONTINUED)

Changes in impairment allowance can be presented as follows:

	31 December 2017	31 December 2016
Balance at the beginning of the year	28,729	26,019
Net changes in impairment allowance (Note 10)	2,005	2,753
Write-offs	(134)	(43)
Balance at the end of the year	**30,600**	**28,729**

Analysis of gross amount of loans by industry:

	31 December 2017	31 December 2016
Corporate loans		
Manufacturing	78,436	78,760
Real estate and rental business, etc.	56,899	24,849
Trade	24,879	29,745
Construction	12,443	12,628
Public administration and defence	10,632	17,736
Agriculture	10,165	10,649
Hospitality	4,326	4,796
Transportation, storage and communication	1,259	4,154
Other	20,937	22,068
	219,976	**205,385**
Retail loans		
Entrepreneurship	5,337	5,397
Housing loans	176	203
	5,513	**5,600**
	225,489	**210,985**

Weighted-average nominal and effective interest rates as at 31 December 2017 and 31 December 2016 were as follows:

	31 December 2017		31 December 2016	
Corporate loans	Nominal i.r.	Effective i.r.	Nominal i.r.	Effective i.r.
Corporate	4.02%	4.35%	4.36%	4.78%
Retail	3.41%	3.67%	3.44%	3.72%

(All amounts are expressed in thousand KM, unless otherwise stated)

15. OTHER ASSETS

	31 December 2017	31 December 2016
Acquired assets	1,422	1,611
Other assets	637	607
Total impairment of other assets	(1,531)	(1,274)
Total other assets (net)	**528**	**944**

The impairment of other assets is mostly related to impairment of assets acquired for further sale.

Changes in impairment can be presented as follows:

	31 December 2017	31 December 2016
Balance at the beginning of the year	1,274	1,158
Impairment of acquired assets (Note 10)	149	107
Impairment of other assets (Note 10)	108	9
Balance at the end of the year	**1,531**	**1,274**

16. PROPERTY AND EQUIPMENT

	Buildings	Vehicles	Furniture and equipment	Total
Cost				
As at 1 January 2016	**7,375**	**196**	**1,612**	**9,183**
Additions	106	2	35	143
Disposals and write-offs	-	(3)	(174)	(177)
As at 31 December 2016	**7,481**	**195**	**1,473**	**9,149**
Additions	2	-	203	205
Disposals and write-offs	-	-	(26)	(26)
As at 31 December 2017	**7,483**	**195**	**1,650**	**9,328**
Accumulated depreciation				
As at 1 January 2016	**2,705**	**55**	**1,400**	**4,160**
Charge for the year	222	28	105	355
Disposals and write-offs	-	(2)	(175)	(177)
As at 31 December 2016	**2,927**	**81**	**1,330**	**4,338**
Charge for the year	224	29	144	397
Disposals and write-offs	-	-	(26)	(26)
As at 31 December 2017	**3,151**	**110**	**1,448**	**4,709**
Net carrying amount				
As at 31 December 2017	**4,332**	**85**	**202**	**4,619**
As at 31 December 2016	**4,554**	**114**	**143**	**4,811**

(All amounts are expressed in thousand KM, unless otherwise stated)

17. INTANGIBLE ASSETS

	Leasehold improvements	Software	Total
Cost			
As at 1 January 2016	**18**	**940**	**958**
Disposals and write-offs	(12)	-	(12)
As at 31 December 2016	**6**	**940**	**946**
Additions	-	6	6
As at 31 December 2017	**6**	**946**	**952**
Accumulated depreciation			
As at 1 January 2016	**6**	**662**	**668**
Charge for the year	3	75	78
Disposals and write-offs	(9)	-	(9)
As at 31 December 2016	**-**	**737**	**737**
Charge for the year	-	70	70
As at 31 December 2017	**-**	**807**	**807**
Net carrying amount			
As at 31 December 2017	**6**	**139**	**145**
As at 31 December 2016	**6**	**203**	**209**

(All amounts are expressed in thousand KM, unless otherwise stated)

18. CURRENT ACCOUNTS AND DEPOSITS FROM CUSTOMERS

	31 December 2017	31 December 2016
Demand deposits		
Private enterprises	5,223	3,513
Cantonal and municipality governments	757	1,863
Individuals and entrepreneurs	495	126
Public companies	286	6,822
Total demand deposits	**6,761**	**12,324**
Purpose deposits		
Government of Federation of Bosnia and Herzegovina	36,721	628
Government of Tuzla Canton	5,075	7,030
Public companies	185	-
Total purpose deposits	**41,981**	**7,658**
Term deposits		
In domestic currency		
Government of Federation of Bosnia and Herzegovina (guarantee deposit)	51,914	38,420
Federal Employment Agency	10,874	26,782
Government of Federation of Bosnia and Herzegovina	5,000	5,000
Government of Federation of Bosnia and Herzegovina – Saudi fund	-	-
Private enterprises	22	22
	67,810	**70,224**
In foreign currency		
Government of Federation of Bosnia and Herzegovina – EUR	231	231
Total term deposits	**68,041**	**70,455**
Total deposits	**116,783**	**90,437**

The Bank does not pay interest on demand deposits, purpose deposits and term deposits, except for one part of a guarantee deposit from the Government of FBiH in the amount of KM 5,000 thousand (1% p.a.).

19. BORROWINGS

	31 December 2017	31 December 2016
Government of Federation of Bosnia and Herzegovina – Saudi Fund loan for development, interest rate 2% p.a. with maturity date 31 August 2021	1,631	2,319
Government of Federation of Bosnia and Herzegovina – Belgian merchandise loan, interest free with maturity date 31 December 2027	651	716
	2,282	**3,035**

In accordance with the contract signed between the Bank and the Government of the FBiH, the Bank has assumed obligation to redeem part of the borrowings as contracted between the Government and the creditors.

(All amounts are expressed in thousand KM, unless otherwise stated)

20. PROVISIONS

	Retirement severance payments	Contingent liabilities	Court proceedings	Total
As at 1 January 2016	**439**	**356**	**38**	**833**
Increase (Note 10)	115	24	-	139
Decrease (Note 10)	(17)	-	(4)	(21)
Decrease due to payment	(41)	-	-	(41)
As at 31 December 2016	**496**	**380**	**34**	**910**
Increase (Note 10)	245	(41)	-	204
Decrease (Note 10)	(3)	-	-	(3)
Decrease due to payment	(41)	-	-	(41)
As at 31 December 2017	**697**	**339**	**34**	**1,070**

As at 31 December 2017, the total value of claims initiated against the Bank amounted to KM 2,635 thousand. Out of this amount, KM 2,233 thousand relate to labour disputes and KM 402 thousand relate to other claims against the Bank.

For part of the labour disputes, the Bank concluded extrajudicial settlements by which the employees waive their claims, and the Bank undertakes to pay the employee's attorneys' fees incurred. Accordingly, for this purpose the Bank formed provisions in the amount of KM 34 thousand.

Given the differing court practices in making decision on labour disputes, the Management of the Bank has not been able to estimate the outcome of the outstanding proceedings, hence provisions have not been created, except for those mentioned above.

Management's estimate is that the Bank will not lose other proceedings against it.

Commitments and contingencies (Off balance sheet exposure) as at 31 December 2017 were as follows:

	31 December 2017	31 December 2016
Performance guarantees	10,362	850
Undrawn lending commitments	2,090	5,355
Advance and payment guarantees	531	825
	12,983	**7,030**

21. OTHER LIABILITIES

	31 December 2017	31 December 2016
Agency liabilities (Note 24)	6,469	15,731
Deferred income	786	709
Trade payables	63	198
Accrued expenses	61	61
Liabilities for interest on deposits	19	19
Other	20	85
	7,418	**16,803**

22. REGISTERED CAPITAL

	%	31 December 2017	%	31 December 2017
Government of Federation of Bosnia and Herzegovina	100	**163,615**	100	**163,615**

According to Article 3 of the Law on Development Bank of the Federation of Bosnia and Herzegovina, the capital was supposed to be increased for the amount of KM 400 million from the budget of the Federation in equal instalments in the period 2008-2011.

Up to 31 December 2017, the Government has not yet provided the capital injection according to the agreed dynamic and amounts.

23. RELATED PARTY TRANSACTIONS

Related parties are entities which directly or indirectly, through on or more intermediaries, control the Bank or are under the Bank's control.

The major part of transactions with related parties comprise of transactions with the Government of the FBiH, the 100% owner of the Bank, and other companies and institutions that are in the Government of the FBiH's major ownership (over 51%).

As of 31 December, balances resulting from related party transactions include:

KM '000	Type of relation	31 December 2017		31 December 2016	
		Receivables	Liabilities	Receivables	Liabilities
Government of Federation of Bosnia and Herzegovina	Owner	-	96,658	-	60,356
Public institutions	Common owner	20	16,641	20	29,192
Companies in majority ownership of the Government of FBiH	Common owner	76,171	352	37,160	6,712
		76,191	**113,651**	**37,180**	**96,260**

KM '000	Type of relation	31 December 2017		31 December 2016	
		Receivables	Liabilities	Receivables	Liabilities
Government of Federation of Bosnia and Herzegovina	Owner	979	92	1,154	100
Public institutions	Common owner	355	-	349	-
Companies in majority ownership of the Government of FBiH	Common owner	3,894	1,577	2,437	505
		5,228	**1,669**	**3,940**	**605**

Remunerations of the Management and Supervisory Board

The remuneration of the members of the Management and Supervisory Board during the year ended 31 December 2017:

	2017	2016
Gross salaries and other benefits	572	317
Supervisory Board members' remunerations	142	118
Other benefits	65	-
	779	**435**

(All amounts are expressed in thousand KM, unless otherwise stated)

24. FUNDS MANAGED FOR AND ON BEHALF OF THIRD PARTIES

The Bank manages significant funds for and on behalf of the Government of Federation of Bosnia and Herzegovina (Ministry of Finance, Ministry of Development, Entrepreneurship and Craft, Ministry of Agriculture, Water Management and Forestry, Ministry of Displaced Persons and Refugees, and Ministry of Environment and Tourism) with the purpose of financing reconstruction projects and Federal Employment Agency projects aimed at financing employment incentives and upkeep of employment. Those assets are held separately from other Bank assets. The bank calculates and charges a fee for those services in accordance with a contract signed with the provider of assets.

	31 December 2017	31 December 2016
PLACEMENTS		
Funds placed per project:		
Water and gas supply	43,031	51,509
Manufacture and processing	42,435	43,145
Healthcare and education	38,167	47,917
Agriculture	36,307	36,391
Employment incentives	12,053	12,251
Road construction and transport	2,240	2,971
Forestry	352	352
Micro finance	-	1,709
Other	2,896	3,091
Total placed by projects:	**177,481**	**199,336**
Receivables for accrued interest and fees	8,769	7,981
Total	**186,250**	**207,317**
SOURCES		
Government of Federation of Bosnia and Herzegovina	171,712	201,030
Federal Employment Agency	12,053	12,251
Other	63	94
Total sources:	**183,828**	**213,375**
Liabilities for accrued interest and fees	8,891	9,673
Total	**192,719**	**223,048**
Current liabilities from funds managed for and on behalf of third parties (Note 21)	**6,469**	**15,731**

The Bank does not bear the risk for these placements and charges a fee for its services.

25. FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks; credit risk, liquidity risk, market risk and operating risk. Market risk includes currency risk, interest rate risk and other price risks.

The Management Board has overall responsibility for the establishment and oversight of the Bank's risk management framework.

Risk management is carried out by the Bank's departments in charge for individual risks under policies suggested by the Management Board, and approved by the Supervisory Board.

Risk steering and risk controlling processes are adjusted in a timely manner to reflect changes in the market environment.

This Note aims to provide information on Bank's exposure to all of the above stated risks, and its goals, policies and procedures aimed to measure and manage the risks, as well as to manage capital of the Bank.

25.1 Credit risk

The Bank is exposed to credit risk which is the risk that a counterparty will not be able to pay amounts in full when due, which will result in the Bank's financial loss.

The credit risk is the most significant risk which the Bank faces in the course of its operations, and it is analyzed and monitored on an individual loan and client basis, as well as in relation to the whole portfolio.

To manage the level of credit risk, the Bank only deals with counterparties which are creditworthy and, if possible, obtains sufficient collateral.

The choice of appropriate securities of the credit exposures depends on:

- Creditworthiness of the client
- Risk of the financed project
- Estimated value of collateral.

In order to minimise credit risk, the Bank applies the Decision on definition, evaluation and treatment of collateral for loan and potential placement security, and secures its credit exposures by taking one or more of the following instruments:

- Cash;
- Bank and corporate guarantees;
- Bills of exchange and unconditional guarantees, issued by the responsible authorities as defined in the Decision;
- Mortgages over properties;
- Pledge over business assets such as equipment, inventory and receivables.

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

The maximum exposure to credit risk without taking into account any collateral or other increased value

	Maximum credit exposure			
	Net exposure	**Contingent liabilities / guarantees**	**Total**	**Fair value of collateral**
31 December 2017				
Cash and cash equivalents	89,797	-	89,797	-
Obligatory reserve with the Central Bank	13,619	-	13,619	-
Loans and receivables from clients	194,889	12,983	207,872	223,104
	298,305	**12,983**	**311,288**	**223,104**
31 December 2016				
Cash and cash equivalents	89,838	-	89,838	-
Obligatory reserve with the Central Bank	9,043	-	9,043	-
Loans and receivables from clients	182,256	7,030	189,286	208,762
	281,137	**7,030**	**288,167**	**208,762**

For statement of financial position items, the above exposures are based on net carrying amounts as shown in the statement of financial position. The table above represents the maximum credit risk exposure as at 31 December 2017 and 31 December 2016, without taking account of any collateral or other increase in value.

Estimated value of property that serves as collateral is determined by the value of the initial evaluation by independent evaluators / real estate agents at the time of loan approval, reduced by a fixed percentage, depending on the type of collateral and reduced proportionately to the extent that it also serves as collateral security for other credit exposure. In order to verify the adequacy of the impairment, the re-valuation of collateral is done in accordance with the principles and rules of the collateral management system, taking into consideration the volatility of the value of the collateral and the time required for its implementation, under the influence of local and global market conditions. Guarantees and promissory notes do not have the declared value in the table, although they are usually required as collateral.

During the year, the Bank, in positions of non-financial assets, has items acquired by taking possession of collateral that are used as collateral in credit exposure in the case of non-repayment of the debt by the debtor. This process of acquiring is mainly related to real estate, equipment, vehicles. The acquired assets are shown as such in the statement of financial position of the Bank at the time when the conditions are met for its acquisition in accordance with IFRS and local regulations. The Bank's policy is to sell the assets acquired in this way, and during the time of ownership of these assets until they are sold to third parties, the assets can be temporarily used for the operations of the Bank or to rent to third parties. The acquired assets are presented in Note 15.

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

25.1.1 Credit risk management and policy provisions and impairment

Restructured loans

During the year, the Bank carried out the restructuring of certain loans to customers, with the aim of achieving better recoverability. Restructuring is usually done after the initial deterioration of the financial situation of the client or for the purpose of preventing further deterioration. After the restructuring, loans continue to be considered as performing loans until the appearance of clear signs of default. Wherever possible, the Bank's position improves by acquisition of additional collateral.

	31 December 2017	31 December 2016
Gross restructured loans	39,542	46,570
Less: impairment allowance	(9,188)	(9,547)
	30,354	**37,023**

For the purpose of credit monitoring and credit risk management, the Bank's credit portfolio is divided into the following groups:

- Performing loans - unimpaired loans (including restructured loans);
- Past due loans that are not recognized as impaired;
- Non-performing loans - impaired loans.

Analysis of the credit portfolio in accordance with the aforementioned categories is as follows:

	31 December 2017	31 December 2016
Banks		
Loans to customers that are neither past due nor impaired	-	-
Past due but not impaired loans	-	-
Non-performing loans (impaired loans)	1,534	1,534
Gross exposure	**1,534**	**1,534**
Less: impairment allowance	(1,534)	(1,534)
Net exposure	**-**	**-**
Corporate		
Loans to customers that are neither past due nor impaired	142,648	142,077
Past due but not impaired loans	7,751	8,771
Non-performing loans (impaired loans)	69,577	54,537
Gross exposure	**219,976**	**205,385**
Less: impairment allowance	(29,852)	(28,215)
Net exposure	**190,124**	**177,170**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

25.1.1 Credit risk management and policy provisions and impairment (continued)

	31 December 2017	31 December 2016
Retail		
Loans to customers that are neither past due nor impaired	1,860	4,579
Past due but not impaired loans	41	51
Non-performing loans (impaired loans)	3,612	970
Gross exposure	**5,513**	**5,600**
Less: impairment allowance	(748)	(514)
Net exposure	**4,765**	**5,086**
Total gross exposure	**227,023**	**212,519**
Portfolio impairment allowance (IBNR)	(4,065)	(5,427)
Specific impairment allowances	(28,069)	(24,836)
Net exposure	**194,889**	**182,256**

a) Loans to customers that are neither past due nor impaired

The quality of the portfolio of loans to customers that are neither past due nor impaired can be assessed through the internal standard monitoring system. Loans to customers are regularly monitored and systematically reviewed in order to identify any irregularities or warning signs. These loans are subject to constant monitoring with the aim of taking timely action based on improvement / deterioration of client risk profile.

An overview of gross exposure of loans to customers that are neither past due nor impaired according to the type of loan is as follows:

	Banks	Corporate	Retail	Total
31 December 2017				
Standard monitoring	-	142,648	1,860	**144,508**
31 December 2016				
Standard monitoring	-	142,077	4,579	**146,656**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

25.1.1 Credit risk management and policy provisions and impairment (continued)

b) Past due but not impaired loans

Loans to and receivables from customers less than 90 days overdue are not considered as impaired, unless other information is available to indicate the contrary. The gross amount of loans to and receivables from customers that were past due but not impaired was as follows:

		Days past due			
	Gross	**Up to 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2017					
Banks	-	-	-	-	-
Corporate	7,751	7,566	185	-	-
Retail	41	-	2	39	-
Total	**7,792**	**7,566**	**187**	**39**	**-**

		Days past due			
	Gross	**Up to 30 days**	**31 – 60 days**	**61 – 90 days**	**Over 90 days**
31 December 2016					
Banks	-	-	-	-	-
Corporate	8,771	7,507	367	897	-
Retail	51	26	25	-	-
Total	**8,822**	**7,533**	**392**	**897**	**-**

c) Non-performing loans

The breakdown of the gross and net amount of the loans to customers that are impaired along with the estimated value of related collateral held by the Bank as security (presented up to the maximum amount of the related exposure), are as follows:

	Banks	Corporate	Retail	**Total**
31 December 2017				
Gross exposure	1,534	69,577	3,612	**74,723**
Impairment	(1,534)	(25,849)	(686)	**(28,069)**
Net	**-**	**43,728**	**2,926**	**46,654**
Impairment rate	*100%*	*37%*	*19%*	*38%*
Exposure share in total loans	*100%*	*24%*	*66%*	*25%*

	Banks	Corporate	Retail	**Total**
Estimated value of collateral as at 31 December 2017				
Deposits	-	925	-	**925**
Mortgages	-	161,221	9,601	**170,822**
Total	**-**	**162,146**	**9,601**	**171,747**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.1 Credit risk (continued)

25.1.1 Credit risk management and policy provisions and impairment (continued)

c) Non-performing loans (continued)

	Banks	Corporate	Retail	**Total**
31 December 2016				
Gross exposure	1,534	54,537	970	**57,041**
Impairment	(1,534)	(22,976)	(326)	**(24,836)**
Net	-	**31,561**	**644**	**32,205**
Impairment rate	*100%*	*42%*	*34%*	*44%*
Exposure share in total loans	*100%*	*27%*	*17%*	*27%*

	Banks	Corporate	Retail	**Total**
Estimated value of collateral as at 31 December 2016				
Deposits	-	-	-	-
Mortgages	-	119,875	3,893	**123,768**
Total	-	**119,875**	**3,893**	**123,768**

25.2 liquidity risk

Liquidity risk arises in the funding of the Bank's activities and in the management of positions. Treating liquidity risk, the Bank consolidates its operations in accordance with the relevant decisions and internal policies aimed at maintenance of liquidity reserves, harmonization of assets and liabilities indicators and liquidity limits.

The Bank has limited access to sources of finance. Funds are raised through a limited number of instruments including deposits of FBiH Government and the Federal Employment Service, deposits of legal entities, borrowings and equity. This limits the flexibility of financing and represents a reliance on deposits and payments of capital by the Government of the Federation.

The Bank strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with different maturities. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals. Furthermore, the Bank holds a portfolio of liquid assets as part of its liquidity risk management strategy.

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.2 Liquidity risk (continued)

The table below shows the remaining contractual maturity of the Bank's assets and liabilities:

31 December 2017	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	89,797	-	-	-	-	**89,797**
Obligatory reserve with the Central Bank	13,619	-	-	-	-	**13,619**
Loans and receivables from clients	13,397	8,114	29,729	115,922	27,727	**194,889**
Other assets	430	1	3	94	-	**528**
Property, equipment and intangible assets	-	-	-	-	4,764	**4,764**
Total assets	**117,243**	**8,115**	**29,732**	**116,016**	**32,491**	**303,597**
Liabilities and equity						
Current accounts and deposits from customers	48,742	-	-	26,420	41,621	**116,783**
Borrowings	-	204	269	1,483	326	**2,282**
Provisions for liabilities and charges	176	44	188	326	336	**1,070**
Other liabilities	7,034	1	127	212	44	**7,418**
Registered capital and reserves	-	-	-	-	176,044	**176,044**
Total liabilities and equity	**55,952**	**249**	**584**	**28,441**	**218,371**	**303,597**
Liquidity gap	**61,291**	**7,866**	**29,148**	**87,575**	**(185,880)**	**-**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.2 Liquidity risk (continued)

31 December 2016	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	89,838	-	-	-	-	**89,838**
Obligatory reserve with the Central Bank	9,043	-	-	-	-	**9,043**
Loans and receivables from clients	11,480	6,956	36,364	109,009	18,447	**182,256**
Other assets	595	-	349	-	-	**944**
Property, equipment and intangible assets	-	-	-	-	5,020	**5,020**
Total assets	**110,956**	**6,956**	**36,713**	**109,009**	**23,467**	**287,101**
Liabilities and equity						
Current accounts and deposits from customers	19,982	-	-	38,420	32,035	**90,437**
Borrowings	-	232	297	2,116	390	**3,035**
Provisions for liabilities and charges	400	11	57	162	280	**910**
Other liabilities	16,148	23	216	393	23	**16,803**
Registered capital and reserves	-	-	-	-	175,916	**175,916**
Total liabilities and equity	**36,530**	**266**	**570**	**41,091**	**208,644**	**287,101**
Liquidity gap	**74,426**	**6,690**	**36,143**	**67,918**	**(185,177)**	**-**

25.3 Market risk

The Bank is exposed to market risks, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, foreign currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

The Management Board sets limits and guidelines for monitoring and mitigating of market risks, which is regularly monitored.

25.3.1 Foreign currency risk

Exposure to currency risk arises from credit, deposit-taking and trading activities and is controlled on a daily basis in accordance with legal and internal limits for each currency, as well as in total amounts for assets and liabilities denominated in or linked to foreign currencies.

Treasury department is responsible for daily management of the Bank's currency position in accordance with legal and internal regulations.

In order to manage foreign exchange rate risk more efficiently, the Bank monitors economic and other business changes in the environment in order to predict possible changes in foreign currency activities, exchange rates, currencies and risk.

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.3 Market risk (continued)

25.3.1 Foreign currency risk (continued)

The following table summarizes the Bank's exposure to foreign currency exchange rate risk at 31 December 2017 and 31 December 2016. The tables include the Bank's assets and liabilities at carrying amounts categorized by currency.

31 December 2017	KM	EUR	USD	Other currencies	Total
Assets					
Cash and cash equivalents	76,331	11,685	1,781	-	**89,797**
Obligatory reserve with the Central Bank	13,619	-	-	-	**13,619**
Loans and receivables from clients	194,870	-	19	-	**194,889**
Other assets	527	1	-	-	**528**
Property, equipment and intangible assets	4,764	-	-	-	**4,764**
Total assets	**290,111**	**11,686**	**1,800**	**-**	**303,597**
Liabilities and equity					
Current accounts and deposits from customers	116,304	233	246	-	**116,783**
Borrowings	-	651	1,631	-	**2,282**
Provisions for liabilities and charges	1,070	-	-	-	**1,070**
Other liabilities	7,414	4	-	-	**7,418**
Registered capital and reserves	176,044	-	-	-	**176,044**
Total liabilities and equity	**300,832**	**888**	**1,877**	**-**	**303,597**
Net foreign exchange position	**(10,721)**	**10,798**	**(77)**	**-**	**-**

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.3 Market risk (continued)

25.3.1 Foreign currency risk (continued)

31 December 2016	KM	EUR	USD	Other currencies	Total
Assets					
Cash and cash equivalents	72,193	15,471	2,174	-	**89,838**
Obligatory reserve with the Central Bank	9,043	-	-	-	**9,043**
Loans and receivables from clients	182,239	-	17	-	**182,256**
Other assets	579	1	-	-	**580**
Property, equipment and intangible assets	5,035	-	-	-	**5,035**
Assets held for sale	349	-	-	-	**349**
Total assets	**269,438**	**15,472**	**2,191**	**-**	**287,101**
Liabilities and equity					
Current accounts and deposits from customers	83,719	6,691	27	-	**90,437**
Borrowings	-	716	2,319	-	**3,035**
Other liabilities	15,913	181	-	-	**16,094**
Provisions for liabilities and charges	910	-	-	-	**910**
Other liabilities	709	-	-	-	**709**
Registered capital and reserves	175,916	-	-	-	**175,916**
Total liabilities and equity	**277,167**	**7,588**	**2,346**	**-**	**287,101**
Net foreign exchange position	**(7,729)**	**7,884**	**(155)**	**-**	**-**

Foreign currency sensitivity analysis

The Bank is mainly exposed to EUR and USD. Since Convertible Mark (BAM) is pegged to EUR, the Bank is not exposed to risk of change in the exchange rate of EUR, but is exposed to changes of EUR in relation to other currencies.

The following table shows the Bank's sensitivity to a 10% increase and decrease in BAM against the USD. 10% is the sensitivity rate used for reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible changes in foreign exchange rates. The analysis includes only outstanding foreign currency denominated monetary items and represent an adjustment to their value at period end for an USD exchange rate movement of 10%. The sensitivity analysis includes external loans that are denominated in a currency other than the currency of the lender or the borrower. A positive number below indicates an increase in profit when BAM strengthens by 10% against the USD. For a 10% weakening of the BAM against the USD, there would be an equal but opposite impact on the profit.

	USD effect	
	31 December 2017	**31 December 2016**
Loss	(8)	(16)

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.3 Market risk (continued)

25.3.2. Interest rate risk

The bank is subject to the risk of interest rate changes, the extent to which interest-bearing assets and liabilities mature or change rates at different times or in different amounts.

The majority of loans to legal entities and individuals are initially contracted at fixed interest rates. These financial instruments are classified as instruments with fixed interest rates, and other such instruments with variable interest rates. The Bank does not pay interest on deposits, except for part of the guarantee deposit of the Government of FBiH KM 5,000 thousand (1% per annum). Decision on establishing and changes in interest rates are made by the Supervisory Board at the proposal of the Board.

Interest rate sensitivity of assets and liabilities

The table below summarizes the Bank's exposure to interest rate risk at the end of the year. Assets and liabilities are presented in the table at book value, and are categorized by the earlier contractual maturity date. Those assets and liabilities that are not applicable interest rates are classified as "Non-interest bearing".

As at 31 December 2017	Non-interest bearing	Less than 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Total	Fixed interest rate	Effective interest rate
Assets									
Cash and cash equivalents	89,797	-	-	-	-	-	**89,797**	-	
Obligatory reserve with the Central Bank	13,619	-	-	-	-	-	**13,619**	-	
Loans and receivables from clients	-	13,397	8,114	29,729	115,922	27,727	**194,889**	194,263	4.31%
Other assets	528	-	-	-	-	-	**528**	-	
Property, equipment and intangible assets	4,764	-	-	-	-	-	**4,764**	-	
Total assets	**108,708**	**13,397**	**8,114**	**29,729**	**115,922**	**27,727**	**303,597**	**194,263**	
Liabilities and equity									
Current accounts and deposits from customers	111,783	-	-	-	-	5,000	**116,783**	5,000	1.00%
Borrowings	651	-	204	204	1,223	-	**2,282**	1,631	2.00%
Provisions for liabilities and charges	1,070	-	-	-	-	-	**1,070**	-	
Other liabilities	7,418	-	-	-	-	-	**7,418**	-	
Registered capital and reserves	176,044	-	-	-	-	-	**176,044**	-	
Total liabilities and equity	**296,966**	**-**	**204**	**204**	**1,223**	**5,000**	**303,597**	**6,631**	
Interest rate risk	**-**	**13,397**	**7,910**	**29,525**	**114,699**	**22,727**	**-**	**187,632**	

(All amounts are expressed in thousand KM, unless otherwise stated)

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.3 Market risk (continued)

25.3.2. Interest rate risk (continued)

Interest rate sensitivity of assets and liabilities (continued)

As at 31 December 2016	Non-interest bearing	Less than 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Total	Fixed interest rate	Effective interest rate
Assets									
Cash and cash equivalents	89,838	-	-	-	-	-	**89,838**	-	
Obligatory reserve with the Central Bank	9,043	-	-	-	-	-	**9,043**	-	
Loans and receivables from clients	-	11,480	6,956	36,364	109,009	18,447	**182,256**	181,229	4.75%
Other assets	944	-	-	-	-	-	**944**	-	
Property, equipment and intangible assets	5,020	-	-	-	-	-	**5,020**	-	
Total assets	**104,845**	**11,480**	**6,956**	**36,364**	**109,009**	**18,447**	**287,101**	**181,229**	
Liabilities and equity									
Current accounts and deposits from customers	85,437	-	-	-	-	5,000	**90,437**	5,000	1.00%
Borrowings	716	-	232	232	1,855	-	**3,035**	2,319	2.00%
Provisions for liabilities and charges	910	-	-	-	-	-	**910**	-	
Other liabilities	16,803	-	-	-	-	-	**16,803**	-	
Registered capital and reserves	175,916	-	-	-	-	-	**175,916**	-	
Total liabilities and equity	**279,782**	**-**	**232**	**232**	**1,855**	**5,000**	**287,101**	**7,319**	
Interest rate risk	**-**	**11,480**	**6,724**	**36,132**	**107,154**	**13,447**	**-**	**173,910**	

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.4. The estimation of fair values of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length conditions. Where available, fair values are based on market prices. However, for a significant part of the Bank's financial instruments, there are no readily available market prices. In conditions when market prices are not readily available, fair value is estimated using discounted cash flows or other appropriate techniques pricing. Changes in the accompanying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates may not be realized in the sale of financial instruments in the current period, particularly taking into account the impact of the global financial crisis and the lack of a liquid market in Bosnia and Herzegovina.

Cash and cash equivalents

The carrying values of cash and balances with banks are generally deemed to approximate their fair values.

Loans to clients

Given the specificity of the Bank, a large amount of the total loan portfolio carries a fixed interest rate and long-term maturity and an interest rate below the market of the interest rate, which reflect the development component of the Bank. Since the bank has no commercial orientation nor set goals that are a rarity for other market participants, it is not practicable to calculate the fair value of loans to customers, nor would the information have particular added value, taking into account the above stated specificities.

Deposits from clients

For demand deposits and deposits with no defined maturities, fair value is the amount payable on demand at the statement of financial position date. The estimated fair value of fixed-maturity deposits is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. It is not practicable to calculate the fair value of fixed-maturity deposits.

Borrowings

Bank borrowings are interest-free or carry a low fixed interest rate. The fair value of borrowings with fixed interest rate is determined using a discounted future cash flows using interest rates currently offered for loans with similar terms and conditions to borrowers with similar credit worthiness. It is not practicable to calculate the fair value of borrowings.

25.5. Capital management

The Bank's objectives when managing capital, which is a broader concept of 'share capital" of the statement of financial position, are:

- To comply with the capital requirements set by the regulators of the banking market in the domestic environment;
- To maintain a strong capital base to support business development.

The Bank's management regularly monitors capital adequacy and the use of regulatory capital on the basis of appropriate techniques that are based on the regulations of the Banking Agency of the Federation of Bosnia and Herzegovina.

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.5. Capital management (continued)

The Bank as at 31 December 2017 was in line with all regulatory capital requirements and in accordance with local regulations achieved a capital adequacy ratio of 98.7% (31 December 2016: 96.00%).

The Bank's regulatory capital for monitoring adequacy according to the Agency's methodology consists of:

- Tier 1 capital or Core Capital: share capital (net of the carrying value of treasury shares), share premium, retained earnings and reserves created by appropriations of retained earnings; negative revaluation reserves arising from the revaluation of the fair value of assets
- Tier 2 capital or Capital or Supplementary Capital: general reserves to cover loan losses, the Bank's assets estimated as good assets and
- Deductible items.

Risk-weighted assets are measured by means of hierarchy of four weights classified according to the nature of the assets and reflecting an estimate of associated credit, market and other risks, taking into consideration all eligible collateral or guarantees. Similar treatment is adopted for off-balance sheet exposures, with certain adjustments made in order reflect the volatility of potential losses.

The table below shows the structure of regulatory capital and capital adequacy indicators at 31 December 2017 and 31 December 2016, in accordance with local regulations (information on risk weighted assets is not audited), taken from the accounts submitted to the Agency for the periods then ended:

	2017 KM '000	2016 KM '000
Tier 1 Capital		
Share capital	163,615	163,615
Reserves	1,458	1,458
Intangible assets	(140)	(203)
Total Tier 1 Capital	**164,933**	**164,870**
Tier 2 Capital		
General reserves – Agency regulations	1,314	1,525
Audited profit for the year	-	-
Total Tier 2 Capital	**1,314**	**1,525**
Adjustment for missing regulatory reserves	(3,925)	(2,659)
Net Capital	**162,322**	**163,736**
Risk weighted assets (unaudited) *	149,434	155,507
Other weighted assets (unaudited) *	14,986	15,011
Total weighted risk assets	**164,420**	**170,518**
Capital adequacy ratio (%)	**98.7%**	**96.0%**

* The risk weighted asset amounts in the table above were calculated in accordance with FBA regulations.

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

25.5. Capital management (continued)

In accordance with the regulations of the Agency, the Decision on minimum standards for managing bank capital and capital protection adopted on 30 May 2014 ("Official Gazette of BiH" No. 46/14), audited profit for the period are included in the calculation of regulatory capital as of the cay when the Audited financial statements are issued and approved by the shareholders of the Bank. In accordance with regulatory requirements in force at the date of the report of 31 December 2016, profit for the period was included in the calculation of regulatory capital if the audited financial statements were approved and adopted by the Supervisory Board prior to submission of the report to the Banking Agency. In the above calculation, audited profit for 2017 was not included in the calculation of capital adequacy as at 31 December 2017.

26. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved by the Management Board on 6 April 2018.

Signed on behalf of the Management Board:

Salko Selman
President of the Management Board

RB FBIH
Sarajevo